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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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| In the Matter of | ) | |
| | ) | |
| Implementation of Sections of | ) | |
| the Cable Television Consumer | ) | MM Docket No. 92-266 |
| Protection and Competition Act | ) | |
| of 1992 | ) | |
| | ) | |
| Rate Regulation | ) | |

To: The Commission

**COALITION OF SMALL SYSTEM OPERATORS
REPLY TO OPPOSITIONS TO
PETITIONS FOR RECONSIDERATION**

The Coalition of Small System Operators, 1/ by its attorneys, hereby replies to certain of the Oppositions to Petitions for Reconsideration in the captioned proceeding.

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1/ The Coalition of Small System Operators consists of: ACI Management, Inc.; Balkin Cable; Buford Television, Inc.; Classic Cable; Community Communications Co.; Douglas Communications Corp. II; Fanch Communications, Inc.; Frederick Cablevision, Inc.; Galaxy Cablevision; Harmon Communications Corp.; Horizon Cablevision, Inc.; Leonard Communications, Inc.; MidAmerican Cable Systems, Limited Partnership; Mid-American Cable Television Association; Midcontinent Media, Inc.; Mission Cable Company, L.P.; MW1 Cablesystems, Inc.; National Cable Television Cooperative, Inc.; Phoenix Cable, Inc.; Rigel Communications, Inc.; Schurz Communications, Inc.; Star Cable Associates; Triax Communications Co.; USA Cablesystems, Inc.; and Vantage Cable Associates. Coalition members own and operate approximately 2,784 headends (representing more than a quarter of the headends in the country), serving approximately 1,297,856 subscribers. Coalition member Mid-American is an association of cable operators serving 1,458,644 subscribers in 1,479 communities located in Kansas, Missouri, Nebraska and Oklahoma. The members of Mid-America have 918 systems with less than 1,000 subscribers. The National Cable Television Cooperative is a purchasing cooperative which represents 360 small and mid-size independent cable companies.

[Footnote continued]

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Significantly, of the 29 Oppositions to and Comments on Petitions for Reconsideration filed in the captioned proceeding, not a single party directly challenged the Coalition of Small System Operators' proposal to utilize a net income analysis in lieu of benchmarks as a first step of rate regulation for small systems. 2/ Although some ancillary issues were addressed in Oppositions, the fact that no one challenged the concept of the net income analysis bodes well for its successful implementation.

While some of the petitioners for reconsideration oppose generally the notion that small systems should be governed by different regulations than larger systems, 3/ none was able to justify the application of the same rules on small

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[Footnote continued]

These companies together serve more than 2.8 million subscribers in over 2,300 communities nationwide. The Coalition participated in the rate regulation rulemaking by filing comments (dated January 27, 1993) and reply comments (dated February 11, 1993) and a Petition for Reconsideration (dated June 21, 1993).

2/ The Coalition provided a detailed description of its proposed net income analysis in its Petition for Reconsideration, filed June 21, 1993, in the captioned proceeding, including a proposed form to calculate a system's net income margin. The only element of the proposal that was not supplied on June 21 was the precise figure for the net income margin below which small systems would be excused from benchmark analysis. The Coalition's economic consultants ultimately determined that 15.5% was a reasonable net income margin (expressed as a percentage of gross revenues), and the Coalition provided this information to the Commission in a Supplement to Petition for Reconsideration filed on July 20, 1993. Even though this figure was submitted just prior to the date for Oppositions to Petitions for Reconsideration in this proceeding, there should not be any opposition to it since no party objected to the concept of the Coalition's proposed net income analysis.

3/ See, e.g., National Association of Telecommunications Officers and Advisors et al. Opposition to Petitions for Reconsideration and Clarification, at 23; Michigan Communities Opposition and Response to Petitions for Reconsideration at 18-21.

systems in view of both their higher costs and their inability to withstand the substantial administrative burdens imposed by the rules.

## I. BENCHMARK RATES ARE TOO LOW FOR SMALL SYSTEMS BECAUSE OF SMALL SYSTEMS' HIGHER COSTS AND LIMITED REVENUE OPPORTUNITIES

Notwithstanding the many Petitions for Reconsideration citing evidence that the Commission's benchmarks are too low, 4/ King County, Washington, et al. defends the Commission's benchmarks, and supports the implementation of rate regulation based on the present benchmarks. King County, Washington, et al. Opposition to Petitions for Reconsideration, at 6-8. In an attempt to discredit the parties that submitted evidence that existing benchmarks are inadequate, King County relies on the proposition that systems can afford to operate with losses during a portion of their franchise because they will ultimately become profitable. And yet, the benchmarks at existing levels will cause losses from which certain operators may not recover. For example, the very small systems (with an average of 266 subscribers) managed by ACI Management, Inc. in Brookshire, Texas and surrounding communities, simply will not be able to continue to operate if they experience any reduction in operating revenues. *See* Coalition of Small System Operators Petition for Reconsideration, Exhibit 6, at 1. Application of existing benchmarks to these systems would triple their existing losses. *Id.* Application of the benchmarks would result in default of debt-to-cash

4/ See, e.g., Cablevision Systems Corporation Response to Petitions for Reconsideration, Advanced Communications, et al. Opposition to Petitions for Reconsideration, at 4-8; Coalition of Small System Operators Petition for Reconsideration, Declaration of William Shew, Director of Economic Studies, Arthur Andersen Economic Consulting.

flow ratios in the forebearance agreement under which they presently operate, and the systems would have to declare bankruptcy. *Id.* Similarly, application of the existing benchmarks to Triax Communications Co.'s Wilsonville, Illinois system would require a reduction in revenues to the point where Triax could not cover its interest payment for the system. *Id.*, Exhibit 7, at 1. Fanch Communications, Inc.'s system serving Greystone, Colorado, also would not generate sufficient revenue over the next year to meet its expenses if it were required to comply with existing benchmarks. *Id.*, Exhibit 3, at 1-3. The requests for relief by small operators do not stem from petty concerns -- rather, in many instances their continued ability to operate their systems and provide service to rural areas is jeopardized by the application of inadequate benchmarks. King County has not provided any evidence to refute the many examples where the application of inadequate benchmarks will have devastating effects on small operators.

The Michigan C-TEC Communities also utterly fail to understand the unique circumstances in which small systems operate. They make the broad allegation that small systems "overcharge" their subscribers. In support of this allegation, they claim that: 1) small systems' rates are higher than those of larger systems; 2) Michigan small systems' rates exceed the benchmarks by greater amounts than larger systems' rates; and 3) small telephone systems in Michigan are very profitable. 5/ Michigan C-TEC Communities Opposition to Petition for Reconsideration, at 19. The claim that small systems' rates in Michigan are higher than larger systems' rates, if true, is consistent with the fact that smaller systems

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5/ Whether small Michigan telephone companies are more or less profitable than large ones is completely irrelevant to rates for small cable systems and will therefore not be addressed have substantially higher costs than larger systems. Moreover, the larger discrepancy between Michigan small systems' rates and the benchmarks indicates that the Commission failed to adequately consider the higher per subscriber costs experienced by small systems when it developed the benchmarks. Therefore, instead of proving that small systems "overcharge," the higher rates and greater differential between rates and benchmarks for small systems in Michigan demonstrate the very points made by the Coalition of Small Systems Operators: small systems have substantially higher per subscriber costs than larger systems, and the FCC's benchmarks fail to take this into consideration.

Parties opposing different treatment for small systems under the Commission's rate regulation scheme also fail to recognize that small systems generally have more limited revenue opportunities than larger systems. For example, in its Opposition, King County suggests that cable systems will recover lost revenues from regulated services by increasing revenues for their unregulated services. However, this revenue shifting is not feasible for many small systems, which may lack the ability to produce local advertising revenues, to offer pay-per-view services, or even to offer a la carte programming. For many small systems, basic service is the only service offered, and revenues related to basic service are the only revenues available.

The unique operations of small systems and the valuable service they provide to rural areas has been recognized by members of Congress. For example, by letter dated June 22, 1993, Senator James M. Jeffords expressed to the FCC's Alexandra Wilson that he is "concerned with the effects of FCC ratemakings upon small, rural cable operators who are trying to establish cable service in [Vermont.]" Similarly, Rep. Alex McMillan criticized the FCC for having "developed rules that do not take into account the high costs sustained by smaller cable systems serving rural areas." Letter to James H. Quello, dated May 25, 1993. Rep. McMillan urged the FCC to adopt rules that will "permit existing operators to recoup the investment already made to provide low density cable" and not to "discourage companies from continuing to build in low density areas." *Id.* The Commission should respond to this direction from Congress by adopting the net income analysis to exclude from benchmark regulation small systems with a net income margin of less than 15.5 percent and revising the benchmarks as proposed by the Coalition of Small System Operators in its Petition for Reconsideration.

## II. CALCULATION OF THE BENCHMARKS SHOULD EXCLUDE MUNICIPAL OVERBUILDS AND SHORT-TERM PRIVATE COMPETITORS

King County attacks the methodology proposed by the Coalition of Small System Operators for the revision of the benchmarks insofar as the Coalition recommends excluding from the database all municipal overbuilds and all private of-way at no charge, and exemption from property taxes and franchise fees -- that are not available to small systems. *Id.* Even though King County gives examples of municipal systems that do pay franchise fees and that do turn a profit, King County Opposition at 17-18, these examples represent only aberrations.

King County also objects to the exclusion from the benchmark calculation of private systems that have faced competition for less than five years. However, King County offers no explanation for the 25 percent difference in rates for systems that have faced competition for less than five years and those that have faced competition for more than five years. The Coalition's economic consultants attribute this substantial difference to price wars during the start-up of competition. *See* Petition for Reconsideration, William Shew Declaration, at 12-15. In view of the danger that the benchmarks could be established based on rates that could not support long-term competition, private short-term competitors must be excluded from the benchmark calculation. Therefore, the only systems from the FCC's benchmark survey database that provide even remotely reliable data for pricing of competitive systems are those that have less than 30 percent penetration. In view of the great harm that could result from the establishment of benchmark rates at a level that would not sustain long-term competition, municipal systems and private systems that have faced competition for less than five years must be excluded from the benchmark database.

## III. APPLICATION OF DIFFERENT RATE REGULATIONS TO SMALL SYSTEMS WILL REDUCE THE NEED FOR BURDENSOME COST-OF-SERVICE PROCEEDINGS

The application of different rate regulations to small systems, as described above, will properly recognize the higher per subscriber costs faced by small operators, and, at the same time, greatly reduce the number of cost-of-service proceedings at the local level and at the FCC. At the opposite end of the spectrum are the unworkable suggestions by NATOA that the Commission: i) limit to extraordinary circumstances the cases where cost-of-service justifications can be made; and ii) retain the same benchmarks and regulatory scheme for small and large systems. Adoption of NATOA's suggestions would be especially unfair to small systems serving low-density areas. These systems, with high per subscriber

Petition for Reconsideration, including a net income analysis where small systems with less than a 15.5 percent net income margin would be excused from further benchmark analysis and the development of benchmarks based on a database that excludes municipal overbuilds and short-term private competitors.

Respectfully submitted,

COALITION OF SMALL
SYSTEM OPERATORS

By [signature]
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Dated: August 2, 1993



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## CERTIFICATE OF SERVICE

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